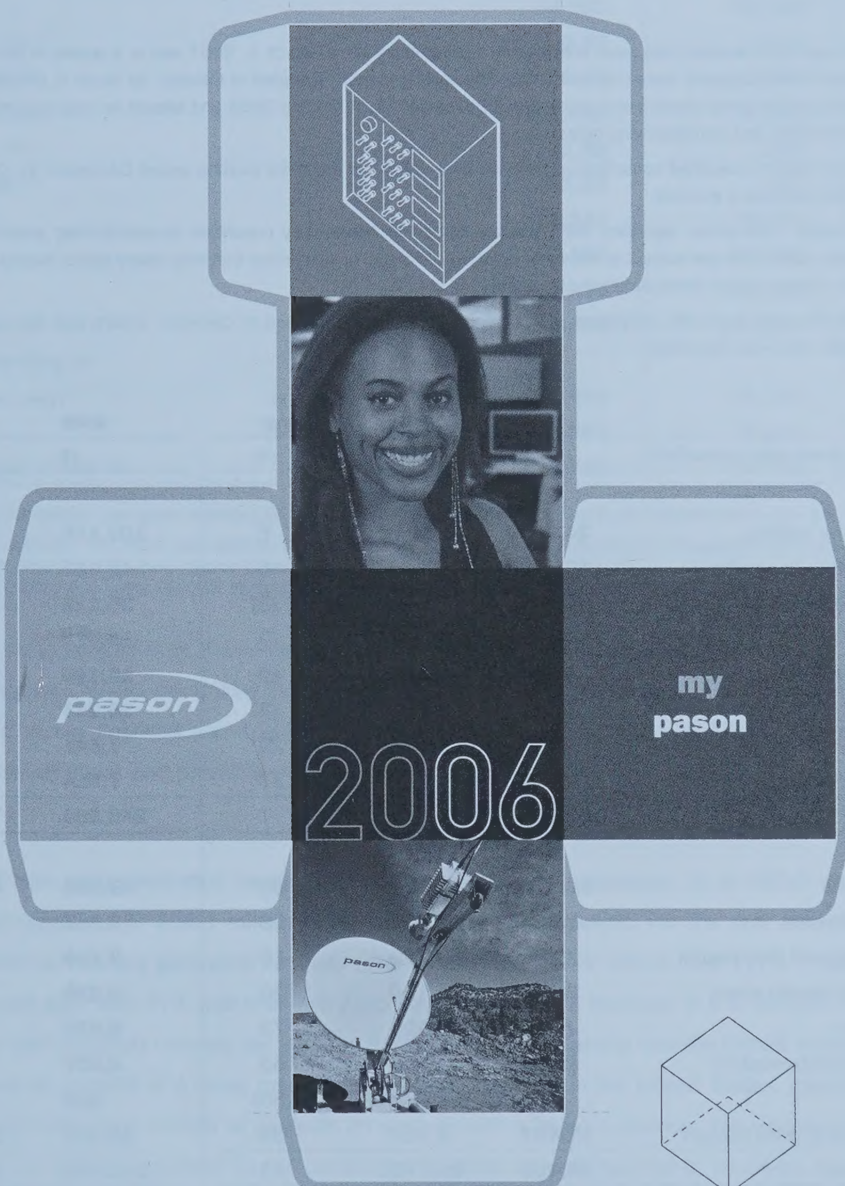


Pason Systems Inc.

2006 Annual Report | Management's Discussion and Analysis
Consolidated Financial Statements

Management's Discussion and Analysis

The following discussion and analysis has been prepared by management as of March 1, 2007 and is a review of the financial condition and results of operations of the Company based on accounting principles generally accepted in Canada. Its focus is primarily a comparison of the financial performance for the three months and years ended December 31, 2006 and 2005 and should be read in conjunction with the consolidated financial statements and accompanying notes.

The interim unaudited consolidated financial information for the three months ended December 31, 2006 and 2005 has not been reviewed by the Company's auditors.

Certain information regarding the Company contained herein may constitute forward-looking statements under applicable securities laws. Such statements are subject to known or unknown risks and uncertainties that may cause actual results to differ materially from those anticipated or implied in the forward-looking statements.

All financial measures presented in this annual report are expressed in Canadian dollars and are post-stock split approved May 15, 2006 unless otherwise indicated.

	THREE MONTHS ENDED DECEMBER 31,			YEARS ENDED DECEMBER 31,		
	2006	2005	Change	**2006**	2005	CHANGE
(000s, except per share data) (unaudited)	*($)*	*($)*	*(%)*	*($)*	*($)*	*(%)*
Revenue						
Drilling recorder rentals	**24,913**	23,516	6	**102,115**	75,608	35
Pit volume totalizer rentals	**12,339**	11,709	5	**48,869**	38,731	26
Communications rentals	**6,064**	6,624	(8)	**25,122**	19,267	30
AutoDriller rentals	**4,886**	4,468	9	**19,012**	11,544	65
Geological services	**4,047**	2,885	40	**15,145**	10,303	47
Total gas rentals	**3,698**	3,792	(2)	**15,266**	10,622	44
Mobilization income	**1,914**	1,528	25	**7,541**	4,823	56
Choke control and other income	**2,099**	1,535	37	**7,514**	4,849	55
Total revenue	**59,960**	56,057	7	**240,584**	175,747	37
Expenses						
Rental services	**16,075**	12,261	31	**63,966**	45,661	40
Geological services	**2,524**	1,857	36	**8,967**	6,532	37
Manufacturing and distribution	**2,636**	2,289	15	**9,459**	6,422	47
Research and development	**2,136**	1,700	26	**8,255**	6,379	29
Administration	**2,097**	1,209	73	**6,699**	4,076	64
Stock-based compensation	**1,297**	849	53	**4,597**	2,595	77
Interest	**33**	279	(88)	**622**	547	14
Depreciation and amortization	**11,557**	8,335	39	**39,923**	27,198	47
Total expenses	**38,355**	28,779	33	**142,488**	99,410	43
Earnings (after taxes)	**15,079**	17,314	(13)	**64,531**	50,280	28
Per share – basic	**0.19**	0.22	(14)	**0.83**	0.66	26
Cash flow from operations	**24,818**	26,758	(7)	**107,451**	79,369	35
Per share – basic	**0.32**	0.35	(9)	**1.38**	1.04	33
Margins						
Rental services	**71%**	77%	(8)	**72%**	72%	–
Geological services	**38%**	36%	6	**41%**	37%	11

For the purposes of cash flow per share calculations, cash flow is defined as earnings adjusted for depreciation and amortization, stock-based compensation expense and future income taxes. This definition is not a recognized measure under Canadian generally accepted accounting principles, and accordingly, may not be comparable to measures used by other companies.

Selected Annual Information

Years Ended December 31,	2006	2005	2004
(000s, except per share data) (unaudited)	*($)*	*($)*	*($)*
Revenue	**240,584**	175,747	122,212
Earnings	**64,531**	50,280	33,842
Per share – basic (1)	**0.83**	0.66	0.46
Per share – diluted (1)	**0.81**	0.64	0.44
Cash flow from operations (2)	**107,451**	79,369	54,640
Per share – basic (1)	**1.38**	1.04	0.73
Per share – diluted (1)	**1.34**	1.01	0.71
Capital expenditures	**71,233**	76,064	41,518
Working capital	**58,495**	23,684	21,540
Total assets	**270,860**	216,306	139,012
Shareholders' equity	**231,209**	163,159	114,747
Average shares outstanding *(#)*			
Basic	**77,899**	76,240	74,658
Diluted	**80,087**	78,544	77,426
Shares outstanding end of year *(#)*	**78,738**	77,045	75,530

(1) *Historical per share information has been adjusted for the two-for-one stock split approved by the shareholders May 15, 2006.*

(2) *For the purposes of cash flow per share calculations, cash flow is defined as earnings adjusted for depreciation and amortization, stock-based compensation expense and future income taxes. This definition is not a recognized measure under Canadian generally accepted accounting principles, and accordingly, may not be comparable to measures used by other companies.*

Pason's revenue is derived from the rental of instrumentation and data services to oil and gas companies and rig contractors throughout Canada, the United States and internationally. For the fiscal year ended December 31, 2006, the Company posted record financial and operating results by continuing to pursue its business strategy of growth through increased market share and providing more products per wellsite.

REVENUE

Revenue, generated from instrumentation rentals and geological services, increased 7% to $60.0 million during the 2006 fourth quarter compared to $56.1 million in the 2005 three-month period. For the year ended December 31, 2006, instrumentation rentals and geological services revenue rose to $240.6 million from $175.7 million recorded in the same period a year ago. This 37% year-over-year jump was due to a 22% increase in the number of United States industry drilling days and improved revenue per industry drilling day in both Canada and the United States. Revenue per industry day improved as a result of a rising market share of rigs, primarily in the United States, carrying at least one Pason product and increasing the number of products on each rig with a Pason presence. The revenue growth recorded in the United States was offset somewhat by the declining U.S. dollar when converted to Canadian currency.

Revenue by Product as a Percentage of Total Revenue

Years Ended December 31,	**2006**	2005
	(%)	*(%)*
Drilling recorder rentals	**43**	43
Pit volume totalizer rentals	**20**	22
Communications rentals	**11**	11
AutoDriller rentals	**8**	7
Total gas rentals	**6**	6
Geological services	**6**	6
Mobilization income	**3**	3
Choke control rentals and other income	**3**	2

Instrumentation Rentals

Pason delivers an integrated package of rental products that offers wellsite data acquisition and drilling management benefits at both the wellsite and in the office. During the fourth quarter of 2006, revenue generated by instrumentation rentals increased 5% to $55.9 million compared to $53.2 million a year ago. For the year ended December 31, 2006, revenue generated by instrumentation rentals totaled $225.4 million versus $165.4 million in 2005. Canadian rental revenue rose 14% to $119.5 million from $104.9 million, rental revenue generated from U.S. operations increased 78% to $100.3 million from $56.4 million, while revenue from international activities improved 36% to $5.6 million from $4.1 million in 2005. Year-over-year differences in currency exchange rates negatively impacted the Company's U.S. rental revenue by $6.8 million. The gross margin (rental revenue less rental expenses) as a percentage of revenue was 71% in the fourth quarter of 2006 versus 77% in 2005 and 72% for both of the years ended 2006 and 2005.

In Canada, the Company's rental revenue per industry drilling day was $717 in the fourth quarter versus $709 in 2005 and $760 per day for the year, up 15% from $662 a year ago. The increase in fourth quarter revenue per day was due to adding more products per wellsite despite the overall reduction in Canadian rig count. In the United States, rental revenue per industry drilling day improved 36% to $196 in the 2006 fourth quarter compared to $144 in the 2005 three-month period and increased 46% to $180 per day for the year versus $123 in 2005.

The daily rental value of the Company's entire current data acquisition, control and data management products generates an economic package of approximately $1,200 per industry drilling day and those in development could add a further $300 per day, creating the potential for continued growth in the drilling industry despite Pason's significant Electronic Drilling Recorder market share in Canada. Beyond instrumentation on drilling rigs, the Company is actively pursuing instrumentation on well service rigs where daily revenue has the potential to approach $250 per day.

Electronic Drilling Recorders

Pason's Electronic Drilling Recorder (EDR) is a complete system of instrumentation and monitoring equipment, which acts as a base for all data capture, data display and communications at the drilling wellsite, that is configured as required and serves as the core of the Company's wellsite presence. In 2006, Pason built 513 new systems to meet the continuing customer demand. At year-end, Pason's electronic data acquisition instrumentation had been installed on 95% of all Canadian rigs reporting to the Canadian Association of Oilwell Drilling Contractors and 50% of all active U.S. land rigs.

Revenue generated from the Company's EDR was up 6% to $24.9 million for the fourth quarter compared to $23.5 million for the same period in 2005. For the year ended December 31, 2006, EDR revenue totaled $102.1 million versus $75.6 million recorded a year ago. The 35% year-over-year revenue growth was primarily due to a 40% increase in Pason's U.S. EDR annual rental days from 170,400 to 238,100 days. Pason's annual EDR rental days in Canada were up slightly from 166,500 in 2005 to 167,300 in 2006. Pason rental days for all products are determined by the accumulated billing days from customer invoices. During 2006, the Company continued to enhance its software to allow its EDRs to take advantage of the broadband Internet access that Pason has made economically viable and available at most wellsites. During 2006, Pason significantly increased its EDR presence in the United States by shipping 352 units or over 69% of its new builds to this market.

Pit Volume Totalizers

The Pit Volume Totalizer (PVT) is Pason's proprietary solution for the detection and early warning of "kicks" that are caused by hydrocarbons entering the wellbore under high pressure and expanding as they migrate to the surface. At year-end, the Company's PVT had been installed on 93% of Canadian and 64% of U.S. rigs operating with a Pason EDR system. Fourth quarter PVT revenue increased 5% to $12.3 million versus $11.7 million in 2005. A 1% and 40% increase in Canadian and U.S. PVT annual rental days, respectively, contributed to the 26% increase in PVT rental revenue to $48.9 million from $38.7 million a year ago. The Company's Canadian PVT annual rental days totaled 156,300 compared to 154,800 days in 2005, while U.S. rental days were 161,100 versus 114,800 days a year ago. Canadian drilling regulations allow operators to reduce surface casing depth when a PVT is employed, thereby justifying the use of this instrument on practically every well.

Communications

During the fourth quarter of 2006, communications rental revenue, which includes the Peloton WellView® operator wellsite daily reporting system, decreased 8% to $6.1 million compared to $6.6 million for the same period in 2005. For the year ended December 31, 2006, communications rental revenue was up 30% to $25.1 million from $19.3 million a year ago. During 2006, $18.6 million or 74% of the total communications revenue was from Canada and $6.5 million from the United States.

Both operator and contractor customers increasingly insist on high-speed communications at the wellsite for e-mail and web application management tools. Pason's proprietary Automatic Aiming Satellite System is the most robust in the industry and, combined with Pason's strong field service presence, has resulted in most customers seeing Pason as the primary provider of wellsite communications. Pason displays all data in standard forms on its Internet DataHub, although if customers require greater analysis or desire to have the information transferred to another supplier's database, data is available for export from the Pason DataHub using WITSML (a specification for transferring data amongst oilfield service companies, drilling contractors and operators).

Peloton WellView® is a drilling data collection and reporting solution that is an integrated addition to Pason's EDR. Building on the wellsite engineering package developed by Peloton Computer Enterprises, a leading provider of this type of product, Peloton WellView® provides a generic engineering database capture module that follows the Pason EDR and the rigs on which it operates.

Total Gas Systems

The Pason Total Gas System (TGAS) measures the total hydrocarbon gases (C1 through C5) exiting the wellbore, and then calculates the lag time to show the formation depth where the gases were produced. The complex system provides a more accurate gas sample than competitor systems while reducing daily maintenance requirements. Revenue generated during the 2006 fourth quarter from Pason's TGAS decreased 2% to $3.7 million compared to $3.8 million recorded in the prior year. For the year ended December 31, 2006, TGAS revenue rose 44% to $15.3 million compared to $10.6 million in 2005. At year-end, Pason's TGAS had been installed on 37% of Canadian and 15% of U.S. land rigs operating with a Pason EDR system.

AutoDrillers

Pason's AutoDriller is used to maintain constant weight on the drill bit while a well is being drilled. At year-end 2006, the Company had a total of 1,104 units versus 824 units in 2005. Revenue from the AutoDriller was up 9% in the fourth quarter of 2006 to $4.9 million from $4.5 million in 2005 and rose 65% for the year to $19.0 million from $11.5 million recorded at December 31, 2005. By the end of 2006, Pason's AutoDriller had been installed on 59% of Canadian and 20% of U.S. land rigs operating with a Pason EDR system.

Choke Control Systems

Pason's Electronic Choke Control System is used to control and remove detected gas "kicks" from the wellbore. During the fourth quarter of 2006, revenue from this product was down 24% to $1.0 million from $1.3 million a year ago and up 3% at year-end to $4.4 million from $4.3 million in 2005. As at December 31, 2006, the Pason Electronic Choke Control System had been installed on approximately 25% of all Canadian rigs in operation. The Company's business model for this product sees Pason providing only the electronic actuation and display, while the drilling contractor is responsible for the choke valve portion of the system. Although this model provides for greater industry safety, it has yet to gain acceptance in the United States, and therefore, to date the vast majority of revenue for this product has been derived from Canada.

Geological Services

Due to the strong link between the geological service provider and the specialized equipment that is employed, in the United States market Pason provides geologists to monitor gas in the drilling returns, to pick formation tops and to analyze drilling cuttings. Historically, manned geological services (commonly referred to as mudlogging) was a minor niche industry employed on only a very small percentage of wells drilled. Pason now offers an entire service spectrum from completely remote geological services to multiple on-site geologists. Fourth quarter revenue from geological services rose 40% to $4.0 million from $2.9 million in 2005, while its annual revenues increased 47% to $15.1 million from $10.3 million recorded a year ago. The gross margin for these services was 41%, up from 37% in 2005, due to improved pricing and better cost control. Although Pason's geological services are primarily concentrated in the U.S. Rocky Mountain region where more complicated drilling structures increase the need for these specialized services, the Company expanded its geological services into Texas and the Williston Basin of Montana and North Dakota. Pason has also begun unmanned remote logging in Canada that is managed from the Company's geological command centre located in Golden, Colorado.

EXPENSES

For the fourth quarter of 2006, total expenses increased 33% to $38.4 million from $28.8 million for the same period in 2005. For the year ended December 31, 2006, total expenses rose 43% to $142.5 million from $99.4 million the prior year. Expenses incurred by the Company have reflected the cost associated with building and maintaining a field service infrastructure to accommodate the levels of activity experienced over the past several years.

Individual Expense Items as a Percentage of Total Expenses

Years Ended December 31,	**2006**	2005
	(%)	*(%)*
Rental services	**45**	46
Depreciation and amortization	**28**	27
Geological services	**6**	7
Research and development	**6**	6
Manufacturing and distribution	**7**	6
Administration	**5**	4
Stock-based compensation	**3**	3
Interest	**–**	1

Rental services expense for the fourth quarter, which represented 42% of the period's total expenses, increased 31% to $16.1 million from $12.3 million a year ago. During 2006, rental services expense, which represented 45% of the year's total expenses, increased 40% to $64.0 million compared to $45.7 million in 2005. These expenses consisted primarily of wages and related benefit costs representing approximately 34% of the total rental services expense in both Canada and the United States, and the additional direct costs of field servicemen, including but not limited to vehicle costs, communication, equipment repairs and freight. Of the $18.3 million year-over-year increase in total rental services expense, $7.1 million was incurred in Canada ($2.9 million for repairs, $2.5 million for labour and related costs, $1.0 million for vehicles and $0.7 million for communication expenses), and $11.2 million incurred in the United States ($4.3 million for labour and related costs, $1.7 million for equipment repairs, $1.7 million for vehicle costs, $1.2 million for communications and $2.3 million for miscellaneous other items). Pason's field service technicians are employed year round, and as a result, the Company's related expenses have a heavily weighted fixed component that is critical to its high service level. At December 31, 2006, Pason employed 201 field service technicians versus 156 at December 31, 2005 – a significant contributor to the increase in overall rental services expense, especially in the United States where throughout the year the Company rapidly increased its work force. To improve the field service component, Pason employs regional rental managers in both its Canadian and U.S. operations.

Geological services expense increased 36% to $2.5 million in the fourth quarter of 2006 from $1.9 million in 2005 and rose 37% to $9.0 million from $6.5 million for the full year. Over 81% or $2.0 million of the $2.5 million year-over-year increase was for labour and related costs. The increase was more than offset by improved prices and demand for on-site geologists. Geological services expense has been typically more variable weighted than the rental services expense.

Costs related to the manufacturing and distribution of Pason products rose 15% to $2.6 million in the 2006 fourth quarter from $2.3 million in 2005 as the Company continued to support its capital expenditure program. For the year, these expenses increased 47% to $9.5 million from $6.4 million a year ago. Approximately 52% of the year-over-year increase was due to higher personnel costs of $1.6 million required to expand the Company's work force in this department. The remainder of the $1.5 million increase included $0.7 million for inventory write-downs, $0.2 million each for warehouse occupancy costs and shop supplies and $0.4 million for miscellaneous smaller accounts.

Research and development expenses, largely labour and overhead related, increased 26% to $2.1 million in the quarter versus $1.7 million in 2005. For the year ended December 31, 2006, R&D expenses were up 29% to $8.3 million from $6.4 million a year ago, while annual capitalized deferred development costs decreased $0.3 million to $1.5 million from $1.8 million in 2005, before investment tax credits received. Labour and related costs accounted for over 66% of the increase in expensed costs in 2005. Approximately 84% of the R&D expenditures were related to current period expenses as opposed to capitalized projects. At December 31, 2006, there were 67 employees devoted to research and development, up from 63 at December 31, 2005.

Administrative expenses for the fourth quarter totaled $2.1 million, a 73% increase over the $1.2 million recorded in the same 2005 period. For the year ended December 31, 2006, these expenses increased 64% to $6.7 million from $4.1 million a year ago. Of the $2.6 million increase, $1.3 million was for labour and related costs, $0.6 million for contracted services, $0.3 million for professional fees and the remainder for increased regulatory compliance costs. The increasing workload being placed upon public companies primarily due to Sarbanes Oxley-related regulatory controls and reporting, inevitably leads to an increased administrative staff. Administrative costs represented 3% of total revenue in 2006 versus 2% in 2005.

All stock options issued to employees and directors have been accounted for using the fair value method of accounting as recommended by the Canadian Institute of Chartered Accountants, which for the year ended December 31, 2006 resulted in an expense of $4.6 million, a 77% increase from the $2.6 million recorded in 2005. The corresponding accounting entry in 2006 created the contributed surplus as shown under shareholders' equity on the Company's balance sheet. As options are exercised, that were previously expensed, share capital and contributed surplus are adjusted accordingly.

Interest expense decreased 88% or $0.2 million in the 2006 fourth quarter and increased 14% or $0.1 million for the year. In a period of strong drilling activity and the resulting improvement in operating cash flow, Pason's capital expenditures were financed from cash flow and the use of its credit facilities due to the timing of the cash flow.

Depreciation and amortization expenses increased 39% to $11.6 million in the 2006 fourth quarter from $8.3 million recorded in the 2005 period. For the year ended December 31, 2006, depreciation and amortization expenses rose 47% to $39.9 million from $27.2 million in 2005, which represented 28% of the year's total expenses in 2006 versus 27% in 2005. A portion of the Company's tangible assets are depreciated using a unit-of-use method of depreciation as it best matches revenue and expenses. Consequently, these expenses rose during 2006 reflecting the increases in rental days. In addition, changes made in accounting estimates over the last several years resulted in cables, which were previously depreciated as part of the EDRs, PVTs and TGAS, being reclassified to their own category and subsequently depreciated on a straight-line basis over 36 months instead of their respective rental days under the unit-of-use method. Satellite systems are also depreciated on a straight-line basis over 36 months. The cumulative impact of these changes resulted in increased depreciation costs in 2006 and a higher fixed portion that is not dependent on use.

Income tax expense decreased 35% to $6.5 million for the three-month period compared to $10.0 million a year ago and rose 29% to $33.6 million for the year ended December 31, 2006 from $26.1 million in 2005. An increase in earnings before tax of $21.8 million, up 29% from 2005, contributed to an increase in total taxes payable for the year. The Company's combined current and future tax rate for 2006 was 34.2% versus 34.1% a year ago.

MARGINS

The margin generated by the Company's rental products declined to 71% in the fourth quarter of 2006 versus 77% in 2005. For the years ended December 31, 2006 and 2005, margins were 72%. The Company improves its margins in Canada primarily from increases in rental products per site and less from price increases. In the United States, the Company is improving margins by increasing market share and the full effect of the November 2005 price increases that impacted 2006. The geological services margin improved to 38% for the fourth quarter of 2006 from 36% in 2005 and rose to 41% for the year from 37% in 2005. This level should be maintained and may improve in 2007 with increased volume.

EARNINGS

Year-over-year fourth quarter earnings decreased 13% to $15.1 million or $0.19 per share basic from $17.3 million or $0.22 per share in the 2005 three-month period. Earnings for the year increased to $64.5 million or $0.83 per share basic from $50.3 million or $0.66 per share basic in 2005. This 28% earnings growth was due primarily to an increase in the Company's revenue as a result of strong drilling activity in the United States and increases to revenue per industry drilling day in both Canada and the United States.

CASH FLOW FROM OPERATIONS (1)

Operating cash flow decreased 7% to $24.8 million or $0.32 per share basic in the fourth quarter of 2006 from $26.8 million or $0.35 per share basic in 2005. For the year ended December 31, 2006, cash flow from operations increased to $107.5 million or $1.38 per share basic from $79.4 million or $1.04 per share basic a year ago. The 35% or $28.1 million cash flow increase was a result of a $14.3 million increase in earnings adjusted for $12.7 million in depreciation and amortization, ($0.9) million in future income tax and $2.0 million in stock-based compensation. During 2006, cash flow was used primarily to finance the Company's capital expenditure program, repay credit facilities and pay common share dividends.

(1) *For the purposes of cash flow per share calculations, cash flow is defined as earnings adjusted for depreciation and amortization, stock-based compensation expense and future income taxes. This definition is not a recognized measure under Canadian generally accepted accounting principles, and accordingly, may not be comparable to measures used by other companies. Cash flow from operations including per share amounts are presented to assist readers in assessing non-discretionary cash flows generated and available for capital expenditures.*

LIQUIDITY AND CAPITAL RESOURCES

At December 31, 2006, the Company's working capital position was $58.5 million versus $23.7 million a year ago. Due to the rental nature of Pason's business, inventory is treated as a capital asset, and as a result, does not affect the Company's working capital.

Proceeds from the exercise of Company stock options totaled $7.5 million compared to $4.9 million in 2005, resulting in the issuance of 1.69 million common shares versus 1.52 million common shares the prior year. The average price on options exercised increased 38% to $4.45 per share from $3.22 per share in 2005.

During 2006, cash flow funded the Company's $71.2 million capital expenditure program, representing a 6% decrease from the prior year's total expenditure amount of $76.1 million. Funds were used to acquire and build $69.7 million of new capital assets and product enhancements with a further $1.5 million spent on deferred development costs versus $74.8 million and $1.3 million, respectively, in 2005. Geographically, $23.9 million of the new capital assets were added to Canada, $40.9 million to the U.S. and $6.4 million internationally. This compares to $46.1 million, $26.3 million and $3.7 million, respectively, a year ago.

At December 31, 2006, the Company had no capital lease obligations.

The Company's maximum operating line of credit is $22.0 million in Canada and US$1.5 million for its United States operations. At December 31, 2006, there were no amounts drawn on these facilities compared to $8.4 million and $nil, respectively, in 2005.

In addition, the Company has a $10.0 million non-revolving term facility, which bears interest at the Canadian bank prime rate plus 0.50% per annum. Borrowings under this facility are repayable by consecutive monthly principal payments. During 2006, the Company fully repaid the amount drawn on this facility.

During 2006, Pason continued to declare and pay semi-annual common share dividends. On June 30, 2006, the Company paid $3.9 million or $0.05 per share. At year-end, the Company had a dividend payable due for payment on January 2, 2007 of $5.9 million or $0.075 per share for total 2006 dividends declared of $9.8 million or $0.125 per share compared to $6.7 million or $0.0875 per share declared and paid in 2005.

DISCLOSURE OF OUTSTANDING SHARE DATA

At March 1, 2007, there were 78.87 million common shares and 6.62 million options issued and outstanding.

	Options Outstanding			Options Exercisable	
Range of Exercise Prices	Options Outstanding	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price	Exercisable (Vested)	Weighted Average Exercise Price
($)	(000s)	(Years)	($)	(000s)	($)
2.88 – 7.25	1,761	1.50	5.05	1,753	5.04
7.26 – 13.50	2,137	1.69	10.08	880	9.61
13.51 – 17.75	2,718	2.51	15.29	400	14.62
	6,616	1.97	10.88	3,033	7.63

Contractual Obligations

	Total	Less than 1 Year	1-3 Years	4-5 Years & Thereafter
(000s)	($)	($)	($)	($)
Operating leases	17,450	5,342	6,693	5,415

NEW PRODUCTS

For competitive and disclosure accuracy reasons, it is the Company's policy not to divulge details of a new product until it is in an advanced prototype stage since its commercial viability is often not determined until that time. Products discussed below are at a stage where they have been demonstrated and deployed in the field with positive responses from customers, but their ultimate market potential is still uncertain.

Electronic Service Recorders

Pason first rolled out a commercial line of Electronic Service Recorders (ESR) for well service rigs in 2005, and by the end of 2006, the ESR was installed on over 200 rigs in Canada. The ESR provides operational monitoring and administrative benefits similar to the EDR on drilling rigs, but is a substantially different product. The typical service rig operation presents new sensoring challenges, more rig control points and an operating environment that is harsher than that of drilling rigs. Although there are more service rigs than drilling rigs in operation in both Canada and the United States, Pason expects revenue per service wellsite to be approximately 25% to that of the drilling wellsite.

LEL and H_2S Gas Monitor

For some time, customers have expressed an interest in Pason monitoring both explosive gases (LEL) and H_2S and having the readings and alarm system integrated with the EDR. Initially, Pason declined because the necessary sensors were not robust enough to be depended upon in the Company's unmanned instrumentation model. However, sensor improvements have now made this possible, first with LEL and most recently with H_2S. Early indication from customers is that this new gas monitoring package will be very popular, and as a result, it could eventually be installed on most rigs.

Drilling Optimizer

During 2005, Pason acquired a drilling optimization software program that will ultimately aid customers in extracting greater value from their drilling data. The software has proved its value with a major Canadian operator, however still requires considerable training and consulting in its operation. Work in 2006 contributed to some improvements in ease of use, but the challenges proved greater than originally anticipated and a new development team has been assembled to continue this work in 2007.

Command Centre Management

Pason products, including the EDR, live rig view, the DataHub and its communications systems, offer the possibility of performing more drilling management remotely. As the cost of retaining experienced workers at the wellsite (including providing for their accommodation and security) increases dramatically, the model of remote management is attracting substantial interest. Pason has already demonstrated the use and success of this model with its geology command centre in its U.S. head office. Other service sub-sectors, such as directional drilling, mud and drill bits, have also been identified as having the potential to benefit from this model. Pason continues discussions with representatives from these service companies, and as a result, an increasing use of Pason products in this field is expected in 2007.

NEW MARKETS

Pason has developed an international business model for renting its equipment in countries where drilling rig instrumentation has typically been purchased. As a result, Pason retains ownership of its equipment while protecting itself from overhead and unexpected costs associated with local service companies. Pason continues to expand its South American operations through its local partner. From the Company's primary base in Argentina, Pason operates in all South American oil producing countries except Venezuela. At December 31, 2006, Pason EDRs were installed on 74 rigs versus 49 rigs in 2005, while AutoDrillers were installed on 47 rigs compared to 24 rigs a year ago.

At year-end 2006, the Company provided instrumentation packages for 17 rigs in Mexico compared to 19 rigs in 2005. The year-over-year decrease was due to a number of rigs working under integrated services contracts that fell idle because of a lack of funding and budget challenges experienced by the national oil company, Pemex. Operations in Australia began during the year with four rigs installed by year-end, each carrying an EDR, PVT and TGAS.

During 2006, international operations contributed $5.7 million to the Company's total rental revenue, an increase of 36% over the $4.2 million contributed in 2005.

ACCOUNTING CHANGES

Beginning in 2007, the Company will be required to adopt the new Section 1530 "Comprehensive Income" standard issued by the Canadian Institute of Chartered Accountants. Under this section, a new financial statement, Consolidated Statement of Other Comprehensive Income, has been introduced that provides that, among other things, foreign currency translation adjustments from self-sustaining foreign operations be temporarily recorded outside the income statement. The Company is evaluating the impact of this new standard, but management does not anticipate that it will have a material impact on the Company's financial position or results of operations.

CRITICAL ACCOUNTING ESTIMATES

The preparation of the consolidated financial statements requires that certain estimates and judgements be made with respect to the reported amounts of revenue and expenses and the carrying value of assets and liabilities. These estimates are based on historical experience and management's judgements, and as a result, the estimates used by management involve uncertainty and may change as additional experience is acquired.

Depreciation and Amortization

The accounting estimates that have the greatest impact on the Company's financial statements are depreciation and amortization. Depreciation of the Company's capital assets includes estimates of useful lives and salvage or residual value. These estimates may change with experience over time so that actual results could differ significantly from these estimates.

Carrying Value of Capital Assets

Long-lived assets are to be tested for impairment at least annually. An impairment loss is required to be recognized when the carrying amount of a long-lived asset exceeds the sum of the undiscounted cash flows expected to result from its use and eventual disposition. Management reviewed the current year and forecast 2007 earnings before interest, taxes, depreciation and amortization for the various assets and determined there were no indications, events or changes in circumstances that would indicate that the carrying amounts may not be recoverable.

RISKS AND UNCERTAINTIES

The major area of uncertainty for Pason is that the demand for its services is directly related to the strength of its customers' capital expenditure programs. The level of capital programs is strongly affected by the level and stability of commodity prices, which can be extremely difficult to predict and beyond the control of Pason and its customers. During periods of uncertainty, oil and gas companies tend to bias their capital decisions on conservative outlooks for commodity prices.

Weakness in commodity prices can also impact the ability of the Company's customers to pay for the services provided. However, as Pason has a very broad customer base and its services are a minor component when looking at the overall cost of drilling a well, the risk is minimal.

Once the associated costs for the implementation of the Kyoto Protocol or other proposed energy reduction programs are determined, customers' cash flows and capital expenditure programs may be affected.

Merger and acquisition activity in the oil and gas exploration and production sector may impact demand for the Company's services, as customers tend to focus on reorganization activities prior to committing funds to major drilling programs.

In addition to the cyclical nature of its business, Pason is also subject to risks and uncertainties associated with weather and seasonality. Pason continues to react to unfavourable weather conditions and spring breakup, which limit well access in Canada, through diversification into geographic regions such as the United States and internationally where these factors are less likely to influence activity.

Pason faces the challenge of attracting and retaining employees to meet its various specialized needs. The Company attempts to overcome this by offering a different, more empowered working culture, an attractive compensation package and training as required to enhance skills.

The Company does not employ hazardous materials, so the possibility of environmental liabilities is limited.

Pason carries adequate levels of insurance to protect the Company. Due to the wide geographical distribution of equipment, the possibility of a loss to a significant portion of its asset base is extremely unlikely. As the Company's equipment is largely unmanned, the customer assumes responsibility for its operations.

The Company has defended its position in patent infringement lawsuits in Canada and the United States regarding the Company's AutoDriller. In 2004 in the United States, the trial court refused to grant the requested injunction to prevent the Company from renting the AutoDriller in that country. In 2006, a Federal Appeals Court vacated the trial court ruling and remanded the case to the trial court to hold a full trial on the merits of the claim of infringement and the Company defences, including that the patent in question is invalid and that there is no infringement. In the Canadian case, the matter is in the early stages. At this time, management's assessment of the outcomes continues to be that the asserted patents are not valid, and as a result, they are not expected to have a significant adverse impact on the Company's financial position or operations.

The Company is involved in other legal actions and potential claims in the normal course of business. In the opinion of management, the aggregate amount of any potential liability is not expected to have a material adverse impact on the Company's financial position or results.

OUTLOOK

Pason continues to be well positioned to profit from increased levels of oilfield activity once this recovery begins. Given the softer commodity prices experienced in the second half of 2006, Canadian drilling activity for the year slowed to 23,900 wells with approximately 157,200 drilling days compared to over 24,700 wells and 158,300 drilling days in 2005. According to the Petroleum Services Association of Canada (PSAC), the estimated activity in 2007 is expected to total 21,500 wells drilled over 159,000 drilling days. The eventual increase in anticipated drilling activity presents an opportunity for Pason products, and therefore, the Company expects to see rising revenues from its new products as well as its established mainline products. Pason anticipates spending $80 million during 2007 to add new products, new units of existing products and enhancements in Canada, and to a greater extent in the United States and internationally where significant room for additional market share exists. The Company will continue to pursue international opportunities that fall within its service model parameters.

Pason's strengths in hardware design, software development, data communications, storage infrastructure and service support allow it to continue to outperform the general industry, and as a result, continue to offer superior shareholder value.

The Company's greatest challenge is to continuously retool processes so that the same strong margins can be realized through increased business. To that end, Pason continues to work on major system improvements in contract manufacturing, capital asset tracking and billings management.

Operational Information

	Industry Drilling Days	Pason Rental Revenue	Revenue Per Industry Drilling Day
(unaudited)	*(#)*	*(CDN$000s)*	*(CDN$)*
Canada [1]			
1997	128,000	12,400	97
1998	89,400	14,800	166
1999	81,800	15,000	183
2000	117,400	29,000	247
2001	120,400	35,900	298
2002	92,000	32,088	349
2003	126,500	56,393	446
2004	132,400	73,149	552
2005	158,300	104,850	662
2006	**157,200**	**119,471**	**760**
United States [2]			
1998	258,400	3,300	13
1999	191,600	4,200	22
2000	281,400	7,500	27
2001	354,400	17,300	49
2002	253,700	16,276	64
2003	329,500	26,962	82
2004	390,700	39,004	100
2005	458,500	56,419	123
2006	**557,800**	**100,273**	**180**

(1) *Source: Canadian Association of Oilwell Drilling Contractors.*

(2) *Baker Hughes weekly active rig count.*

Years Ended December 31,	Canada 2006	2005	United States 2006	2005
(unaudited)				
EDR rental days *(#)*	**167,300**	166,500	**238,100**	170,400
PVT rental days *(#)*	**156,300**	154,800	**161,100**	114,800
EDR revenue per rental day *($)*	**277**	263	**223**	174
PVT revenue per rental day *($)*	**161**	153	**142**	126

Numbers are impacted by the EDR configurations in each country and by the stronger Canadian dollar in 2006 versus 2005.

Summary of Quarterly Results

Three Months Ended	Mar.31, 2005	Jun.30, 2005	Sep.30, 2005	Dec.31, 2005	**Mar.31, 2006**	**Jun.30, 2006**	**Sep.30, 2006**	**Dec.31, 2006**
(000s, except per share data)	*($)*	*($)*	*($)*	*($)*	*($)*	*($)*	*($)*	*($)*
(unaudited)								
Revenue	41,719	29,796	48,175	56,057	**68,352**	**48,296**	**63,976**	**59,960**
Earnings	13,665	4,994	14,307	17,314	**20,130**	**11,620**	**17,702**	**15,079**
Per share – basic (1)	0.18	0.07	0.19	0.22	**0.26**	**0.15**	**0.23**	**0.19**
Per share – diluted (1)	0.18	0.06	0.18	0.22	**0.25**	**0.14**	**0.22**	**0.19**
Cash flow from operations (2)	20,036	10,620	21,955	26,758	**33,206**	**19,659**	**29,768**	**24,818**
Per share – basic (1)	0.26	0.14	0.29	0.35	**0.43**	**0.25**	**0.38**	**0.32**
Per share – diluted (1)	0.25	0.14	0.27	0.35	**0.41**	**0.24**	**0.37**	**0.31**

(1) *Historical per share information has been adjusted for the two-for-one stock split approved by the shareholders May 15, 2006.*

(2) *For the purposes of cash flow per share calculations, cash flow is defined as earnings adjusted for depreciation and amortization, stock-based compensation expense and future income taxes. This definition is not a recognized measure under Canadian generally accepted accounting principles, and accordingly, may not be comparable to measures used by other companies.*

Q4 – 2006

- Quarterly revenue increased 7% to $60.0 million, while earnings decreased 13% to $15.1 million and earnings per diluted share decreased 14% to $0.19 versus the same period in 2005.

Q3 – 2006

- Best ever third quarter revenue of $64.0 million, a 33% increase, while net earnings improved 24% to $17.7 million and earnings per diluted share rose 22% to $0.22 over 2005.

Q2 – 2006

- Strongest second quarter in history with revenue totaling $48.3 million, a 62% increase. Net earnings improved 133% to $11.6 million and earnings per diluted share rose 133% to $0.14 over the same period in 2005.

Q1 – 2006

- Quarterly revenue increased 64% to $68.4 million, earnings grew 47% to $20.1 million and earnings per diluted share rose 39% to $0.25 versus the 2005 first quarter.

Q4 – 2005

- Fourth quarter revenue improved 53% to $56.1 million, while earnings rose 47% to $17.3 million and earnings per diluted share increased 50% to $0.22 versus the same period in 2004.

Q3 – 2005

- Third quarter revenue rose 62% to $48.2 million, earnings were up 82% to $14.3 million and earnings per diluted share improved 80% to $0.18 compared to the 2004 three-month period.

Q2 – 2005

- Second quarter revenue was $29.8 million, a 40% increase, while earnings improved 41% to $5.0 million and earnings per diluted share rose 33% to $0.06 over the same period in 2004.

Q1 – 2005

- Revenue increased 20% to $41.7 million, earnings grew 28% to $13.7 million and earnings per diluted share rose 25% to $0.18 versus the 2004 first quarter.

Variations in Pason's quarterly financial results are due in part to the seasonality of the oil and gas service industry in Canada, which is somewhat offset by the less seasonal nature of United States and international operations. The first quarter is generally the strongest quarter for the Company due to strong activity in northern areas when location access is best during the winter. The second quarter is always the slowest due to spring breakup in Canada when many areas are not accessible due to ground conditions, and therefore, do not permit the movement of heavy equipment. Activity generally increases in the third quarter, depending on the year, as ground conditions have often improved and location access becomes available; however, a rainy summer can have a significant adverse effect on drilling activity. By the fourth quarter, often the Company's second strongest quarter, access to most areas becomes available with ground freezing. Consequently, the performance of the Company may not be comparable quarter to consecutive quarter and should be considered on the basis of results for the whole year, or by comparing results in a quarter with results in the same quarter for the previous year.

STATEMENT REGARDING INTERNAL CONTROLS OVER FINANCIAL REPORTING AND DISCLOSURE CONTROLS

As of December 31, 2006, the Company had carried out a review of internal controls over financial reporting under the supervision of and with the participation of management, including the President and Chief Executive Officer and the Chief Financial Officer. Changes in internal controls that have affected, or are likely to affect, financial reporting have been identified and are outlined below.

Daily Charge Record

In 2006, the Company undertook a project in Canada to replace the paper ticket approval process previously in use with an electronic pre-approval process at the wellsite. The electronic approval process is intended to eliminate billings' delays while waiting for paper backup and improve the accuracy and timeliness of invoicing for customers.

Asset Tagging and Tracking

Pason is currently in the process of tagging all rental equipment with barcode labels that uniquely identify each asset. The goal of the project is to improve asset tracking and to enable the Company to locate assets at a specific geographical location. This will enable the Company to more efficiently and effectively manage rental equipment in the field.

Pason has rental assets operating on the majority of land-based drilling rigs in North America. These rigs are constantly moving as drilling programs evolve. Due to the inherent difficulty of locating all of Pason's rental assets in the field and the current status of internal controls related to capital assets, it is possible that the Company will not be able to track and locate 100% of all rental equipment. These factors have been considered in choosing and consistently applying the Company's depreciation policy. Once completed, this project will significantly improve the Company's internal control over capital asset management. Based on asset identification results to date, management's assessment is that a potential write-off of rental equipment that cannot eventually be located is not expected to have a significant adverse impact on the Company's financial position or operations.

The President and Chief Executive Officer and the Chief Financial Officer have also concluded that disclosure controls and procedures have remained effective during 2006.

SEDAR

Additional information relating to the Company can be accessed on the Company's website at www.pason.com and on the Canadian Securities Administrators' System for Electronic Document Analysis and Retrieval (SEDAR) at www.sedar.com.

Management's Report

TO THE SHAREHOLDERS OF PASON SYSTEMS INC.

The accompanying consolidated financial statements are the responsibility of management and have been approved by the Board of Directors of the Company. Management is responsible for and has prepared and presented the consolidated financial statements in accordance with Canadian generally accepted accounting principles ("GAAP") and has made significant accounting judgements and estimates as required. Management has ensured that financial information contained elsewhere in this Annual Report is consistent with the consolidated financial statements.

Management has prepared the Management's Discussion and Analysis ("MD&A"). The MD&A is based on the Company's financial results prepared in accordance with Canadian GAAP. The MD&A compares the audited financial results for the years ended December 31, 2006 and 2005.

The Audit Committee of the Board of Directors, which is comprised of three independent directors, has discussed the consolidated financial statements, including the notes thereto, with management and the external auditors. The Board of Directors has approved the consolidated financial statements on the recommendation of the Audit Committee.

JAMES D. HILL
President & Chief Executive Officer

JIM GLASSPOOLE
Chief Financial Officer

Calgary, Alberta
March 1, 2007

Auditors' Report

TO THE SHAREHOLDERS OF PASON SYSTEMS INC.

We have audited the consolidated balance sheets of Pason Systems Inc. as at December 31, 2006 and 2005 and the consolidated statements of earnings and retained earnings and of cash flows for the years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2006 and 2005 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

Deloitte & Touche LLP

Chartered Accountants

Calgary, Alberta
February 16, 2007

Consolidated Balance Sheets

DECEMBER 31,	2006	2005
(000s)	*($)*	*($)*
Assets		
Current		
Cash	**21,857**	–
Accounts receivable	**70,173**	64,942
Prepaid expenses	**1,816**	1,585
	93,846	66,527
Investment *(Note 5)*	**3,000**	3,000
Capital assets *(Note 6)*	**171,458**	144,399
Deferred development costs *(Note 7)*	**2,556**	2,380
	270,860	216,306
Liabilities		
Current		
Bank indebtedness *(Note 8)*	**–**	6,459
Accounts payable and accrued liabilities	**22,256**	21,744
Income taxes payable	**7,192**	8,926
Dividend payable *(Note 9)*	**5,903**	–
Current portion of non-revolving term credit facility *(Note 8)*	**–**	5,714
	35,351	42,843
Long-term portion of non-revolving term credit facility *(Note 8)*	**–**	4,286
Future income taxes *(Note 10)*	**4,300**	6,018
	39,651	53,147
Shareholders' Equity		
Share capital *(Note 9)*	**38,085**	29,496
Contributed surplus *(Note 9)*	**7,130**	3,580
Foreign currency translation adjustment	**(10,353)**	(11,526)
Retained earnings	**196,347**	141,609
	231,209	163,159
	270,860	216,306

APPROVED BY THE BOARD OF DIRECTORS

H.R. Allsopp

Harold R. Allsopp
Director

J.B. Howe

James B. Howe
Director

Consolidated Statements of Earnings and Retained Earnings

YEARS ENDED DECEMBER 31,	2006	2005
(000s, except per share data)	*($)*	*($)*
Revenue		
Rental revenue	**225,439**	165,444
Geological services	**15,145**	10,303
	240,584	175,747
Expenses		
Rental services	**63,966**	45,661
Geological services	**8,967**	6,532
Manufacturing and distribution	**9,459**	6,422
Research and development	**8,255**	6,379
Administration	**6,699**	4,076
Stock-based compensation *(Note 9)*	**4,597**	2,595
Interest	**622**	547
Depreciation and amortization *(Notes 6 and 7)*	**39,923**	27,198
	142,488	99,410
Earnings before income taxes	**98,096**	76,337
Income taxes *(Note 10)*		
Current	**35,165**	26,761
Future	**(1,600)**	(704)
	33,565	26,057
Earnings	**64,531**	50,280
Retained earnings, beginning of year	**141,609**	98,032
Dividends	**(9,793)**	(6,703)
Retained earnings, end of year	**196,347**	141,609
Earnings per share *(Note 12)*		
Basic	**0.83**	0.66
Diluted	**0.81**	0.64

Consolidated Statements of Cash Flows

YEARS ENDED DECEMBER 31,	2006	2005
(000s)	*($)*	*($)*
Cash flows related to the following activities:		
Operating		
Earnings	**64,531**	50,280
Adjustments for non-cash items:		
Depreciation and amortization	**39,923**	27,198
Stock-based compensation	**4,597**	2,595
Future income taxes	**(1,600)**	(704)
	107,451	79,369
Changes in non-cash working capital *(Note 15)*	**(4,256)**	(22,968)
	103,195	56,401
Financing		
Issue of common shares under the stock option plan	**7,542**	4,873
Proceeds from non-revolving term facility	**–**	10,000
Repayment of non-revolving term facility	**(10,000)**	(583)
Payment of dividends *(Note 9)*	**(3,890)**	(6,703)
Dividend payable *(Note 9)*	**5,903**	–
	(445)	7,587
Investing		
Additions to capital assets	**(69,698)**	(74,742)
Long-term investment	**–**	(3,000)
Deferred development costs	**(1,535)**	(1,322)
Proceeds on disposal of capital assets	**387**	346
Changes in non-cash working capital	**(3,588)**	6,635
	(74,434)	(72,083)
Net increase (decrease) in cash and cash equivalents	**28,316**	(8,095)
Cash and cash equivalents, beginning of year	**(6,459)**	1,636
Cash and cash equivalents, end of year	**21,857**	(6,459)
Represented by:		
Cash	**15,954**	1,891
Cash held in trust *(Note 9)*	**5,903**	–
Bank indebtedness	**–**	(8,350)
Cash and cash equivalents	**21,857**	(6,459)
Supplemental cash flow information		
Interest paid	**624**	545
Income tax paid	**37,012**	18,874

Notes to Consolidated Financial Statements

YEARS ENDED DECEMBER 31, 2006 AND 2005

(000s, except per share data)

1. Description of Business

Pason Systems Inc. (the "Company") designs and manufactures specialized proprietary instrumentation for rent on land-based drilling and service rigs.

2. Basis of Presentation

These consolidated financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles. The accompanying consolidated financial statements include the accounts of Pason Systems Inc. and its wholly owned subsidiaries, Pason Systems Corp., Pason US Holdings Corp., Pason de Mexico S.A. de C.V. , Pason Australia Pty Limited and Pason Systems USA Corp., a wholly-owned subsidiary of Pason US Holdings Corp. All inter-company transactions have been eliminated.

Certain comparative figures have been reclassified to conform to the current year's presentation.

3. Change in Accounting Estimate

In 2005, management made a decision, based on operating experience, to change the salvage value for the unit-of-use depreciation based assets from 10% to 5%, which includes the electronic drilling recorders, pit volume totalizers, electronic choke controls, total gas systems and AutoDrillers. This change in accounting estimates was applied prospectively from January 1, 2005.

The impact of this change for the year ended December 31, 2005 was to increase depreciation expense by $1,107 from what would have been otherwise recorded.

4. Significant Accounting Policies

Cash and Cash Equivalents

Cash reflects cash on deposit, cash held in trust and bank indebtedness.

Investments

Investments are recorded at cost. If there are other than temporary declines in value, investments are recorded at realizable value.

Capital Assets

Capital assets include parts and raw materials awaiting assembly. These assets are recorded at cost and no depreciation is taken.

The electronic drilling recorders and AutoDrillers are recorded at cost and are depreciated using a unit-of-use method based on 1,350 rental days with a 5% salvage value. Pit volume totalizers and electronic choke controls are recorded at cost and are depreciated using a unit-of-use method based on 1,800 rental days with a 5% salvage value. Total gas systems are recorded at cost and are depreciated using a unit-of-use method based on 1,125 rental days with a 5% salvage value.

Geological services equipment is recorded at cost and is depreciated on a straight-line basis over 60 months. Satellite systems and electronic cables are recorded at cost and depreciated on a straight-line basis over 36 months.

Leasehold improvements are amortized on a straight-line basis over the terms of the leases, which range from two to ten years.

All remaining capital assets are recorded at cost and are depreciated using the declining-balance method at the following annual rates:

Trucks and truck boxes	30%
Other	20%

4. Significant Accounting Policies (continued)

Research and Development

The Company expenses all research expenditures as incurred, net of related investment tax credits received. Development costs, net of related investment tax credits, are expensed as incurred unless they meet the criteria for deferral and amortization under Canadian generally accepted accounting principles.

Development costs incurred on new product development projects, which in management's view have clearly defined market prospects, are technologically feasible and for which the Company intends to commit resources, are deferred and amortized over three years commencing in the year in which the new products begin generating rental revenue. However, if at any time a product is deemed no longer commercially viable, the balance of the related deferred costs is expensed.

Foreign Currency Translation

The accounts of the Company's self-sustaining foreign operations are translated into Canadian dollars using the current rate method. Assets and liabilities are translated at the period-end exchange rate and revenues and expenses are translated at average semi-monthly exchange rates. Gains and losses arising from the translation of the financial statements of the foreign operations are deferred in a foreign currency translation adjustment account in shareholders' equity.

Monetary assets and liabilities relating to foreign denominated transactions are initially recorded at the rate of exchange in effect at the transaction date. Gains and losses resulting from subsequent changes in foreign exchange rates are recorded in earnings for the period.

Income Taxes

The Company follows the liability method of accounting for income taxes. Under this method, the Company records future income taxes for the effect of any differences between the accounting and income tax basis of an asset or liability. The effect of a change in income tax rates on future income tax assets and liabilities is recognized in the period that the change is substantively enacted, based on the rates in effect when the temporary differences are expected to reverse. Investment tax credits are recorded when received.

Revenue Recognition

Revenue is recognized during the reporting period based on completion of each rental day for products and services, provided collectibility is reasonably assured.

Impairment of Long-Lived Assets

The Company determines whether the net carrying amount of capital assets is recoverable from future undiscounted cash flows at least annually at year-end or when indicators of impairment exist. The Company's operations along with the market and business environment are continually monitored. Judgements and assessments are made to determine whether an event has occurred that indicates a possible impairment. If such an event has occurred, an estimate is made of future undiscounted cash flows from the capital asset. If the total of the undiscounted future cash flows, excluding finance charges, is less than the carrying amount of the capital assets, asset impairment must be recognized in the financial statements. The amount of the impairment to be recognized is calculated by subtracting the fair value of the asset from the carrying value of the asset. Fair value is the amount at which an item could be bought or sold in a current environment between willing parties, and is estimated by calculating the present value of expected future cash flows related to the asset.

Stock-Based Compensation Plans

The Company has a stock option plan under which stock options are accounted for using the fair value method estimated on the date of grant using the Black-Scholes option pricing model. Consideration received on the exercise of stock options together with the amount of non-cash compensation expense recognized in contributed surplus, for these same options, is recorded as an increase in share capital.

4. Significant Accounting Policies (continued)

Use of Estimates

The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenue and expenses during the reporting period. The most significant of these estimates are related to the amortization period for capital assets, the valuation of capital assets, the assessment of the viability of new product development projects, the provision for doubtful accounts receivable, stock-based compensation and the provision for future income taxes. Actual results could differ from these estimates.

Earnings Per Share

Basic earnings per share are calculated by dividing the earnings available to common shareholders by the weighted average number of common shares outstanding. Diluted earnings per share, which reflect the potential dilution that would occur if in-the-money stock options were exercised, is calculated using the treasury stock method.

Recent Accounting Pronouncements

Beginning in fiscal year 2007, the Company will be required to adopt the new Section 1530 "Comprehensive Income" standard issued by the Canadian Institute of Chartered Accountants. Under this section, a new financial statement, Consolidated Statement of Other Comprehensive Income, has been introduced that provides for, among other things, that foreign currency translation adjustments from self-sustaining foreign operations be temporarily recorded outside the income statement. The Company is evaluating the impact of this new standard, but management does not anticipate that this will have a material impact on the Company's financial position or results of operations.

5. Investment

The Company has a portfolio investment in shares of a private company that is recorded at cost of $3,000. There is no quoted price in an active market for these shares, and therefore, this investment is carried at cost.

6. Capital Assets

	Cost	Accumulated Depreciation and Amortization	Net Book Value
	($)	($)	($)
2006			
Parts and raw materials	**24,727**	**—**	**24,727**
Rental equipment	**222,910**	**84,430**	**138,480**
Other	**21,192**	**12,941**	**8,251**
	268,829	**97,371**	**171,458**
2005			
Parts and raw materials	25,113	–	25,113
Rental equipment	164,972	52,532	112,440
Other	20,167	13,321	6,846
	210,252	65,853	144,399

Depreciation and amortization expense recorded with respect to capital assets in 2006 was $38,564 (2005 – $25,958). Included in depreciation and amortization expense are losses on the disposal of assets in the amount of $2,376 (2005 – $1,024). No impairment of capital assets has been recorded for 2006 or 2005.

7. Deferred Development Costs

	2006	2005
	($)	($)
Accumulated costs, beginning of year	**7,837**	6,515
Additional costs deferred during the year	**1,552**	1,796
Investment tax credits received	**–**	(287)
Non-commercial project costs expensed during the year	**(17)**	(187)
	9,372	7,837
Accumulated amortization	**(6,816)**	(5,457)
Net deferred development costs, end of year	**2,556**	2,380

The amortization recorded in 2006 was $1,359 (2005 – $1,240).

8. Credit Facilities

The Company's subsidiary, Pason Systems Corp., has a $22.0 million demand credit facility, which bears interest at the Canadian bank prime rate plus 0.50%. At December 31, 2006, an amount of $Nil had been drawn on this credit facility (2005 – $8,350). The credit facility is used by the Company for working capital purposes, and accordingly, amounts drawn against it are recorded as bank indebtedness offset by any excess cash balances. The total amount under this facility cannot exceed 75% of trade receivables.

In addition, the Company has available a $10.0 million non-revolving term facility, which bears interest at the Canadian bank prime rate plus 0.50%. Borrowings under this facility are repayable by consecutive monthly principal payments with the balance to be repaid in full by September 30, 2007. At December 31, 2006, an amount of $Nil was outstanding on this facility (2005 – $10,000).

The Company can repay, without penalty, advances under either facility. The term facility, together with the demand credit facility, are secured by a general security agreement from Pason Systems Corp. and Pason Systems USA Corp.

The Company is subject to certain financial covenants that have been met at December 31, 2006 and 2005.

The effective average interest rate in 2006 on all borrowings under both facilities was 6.06% (2005 – 4.81%).

The Company's U.S. subsidiary has available a US$1.5 million revolving line of credit at U.S. bank prime rate less 0.50%. No amounts were outstanding on December 31, 2006 and 2005.

9. Share Capital

Authorized

Unlimited number of common shares

Unlimited number of preferred shares, issuable in series

Issued

Common shares

	Shares	Amount
	(#)	($)
Balance, December 31, 2004	75,529	24,226
Exercise of stock options	1,516	4,873
Contributed surplus adjustment on exercise of stock options	–	397
Balance, December 31, 2005	77,045	29,496
Exercise of stock options	**1,693**	**7,542**
Contributed surplus adjustment on exercise of stock options	**–**	**1,047**
Balance, December 31, 2006	**78,738**	**38,085**

9. Share Capital (continued)

On May 15, 2006, the shareholders of the Company voted in favour of a two-for-one subdivision of the Company's common shares. Upon completion of the share split on May 31, 2006, the Company had 77,698 common shares outstanding. During 2005, shareholders approved a similar two-for-one subdivision of the common shares. All comparative per share information has been restated accordingly to reflect these two-for-one splits.

Stock Option Plan

At December 31, 2006, 6,889 stock options were outstanding for common shares at exercise prices ranging from $2.88 to $17.75 per share, expiring between 2007 and 2010 as follows:

	2006		2005	
	Share Options	**Weighted Average Exercise Price**	Share Options	Weighted Average Exercise Price
	(#)	($)	(#)	($)
Outstanding, beginning of year	**7,110**	**7.92**	5,910	4.72
Granted	**2,096**	**15.67**	3,242	11.61
Exercised	**(1,693)**	**4.45**	(1,516)	3.22
Forfeited	**(624)**	**11.09**	(512)	8.49
Expired	**–**	**–**	(14)	1.56
Outstanding, end of year	**6,889**	**10.84**	7,110	7.92
Exercisable, end of year	**2,879**		2,562	
Available for grant, end of year	**985**		594	

All options are issued at market price and vest over three years. Options issued prior to November 2004 expire five years after the date of issuance. Effective November 2004 through October 2006, options granted expire three years and 60 days after issuance. Effective November 2006, options granted expire three years and six months after issuance.

The following table summarizes information about stock options outstanding at December 31, 2006:

	Options Outstanding			Options Exercisable	
Range of Exercise Prices	Options Outstanding	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price	Exercisable (Vested)	Weighted Average Exercise Price
($)	*(#)*	*(Years)*	*($)*	*(#)*	*($)*
2.88 – 7.25	**1,854**	**1.67**	**5.04**	**1,804**	**4.99**
7.26 – 13.50	**2,237**	**1.86**	**10.06**	**728**	**9.51**
13.51 – 17.75	**2,798**	**2.67**	**15.30**	**347**	**14.28**
	6,889	**2.14**	**10.84**	**2,879**	**7.25**

The Company is authorized to issue a maximum of 30,000 shares under its stock option plan of which 26,393 options have been granted; 6,889 options are outstanding; 4,507 options have been cancelled; and 8,114 options are available for issue at December 31, 2006. The total number of options outstanding must not exceed 10% of the total common shares outstanding.

Stock options issued to employees and directors have been accounted for using the fair value method and recorded as stock-based compensation expense of $4,597 (2005 – $2,595) in the consolidated statement of earnings, using the following weighted average assumptions and the fair value of stock options granted at $3.98 per share (2005 – $2.68), using a forfeiture rate of 17% (2005 – 16%):

9. Share Capital (continued)

Stock Option Plan (continued)

Years Ended December 31,	**2006**	2005
Risk free interest rate *(%)*	**4.12**	3.39
Expected option life *(years)*	**3.14**	3.13
Expected volatility *(%)*	**31.98**	29.53
Annual dividends per share *(%)*	**1.0**	1.0

Amounts recorded to contributed surplus of $4,597 (2005 – $2,595) relating to the fair value of stock options expensed and subsequent reduction for options exercised are as follows:

Contributed Surplus

	Amount
	($)
Balance, December 31, 2005	3,580
Stock-based compensation expense for the year	4,597
Stock options exercised	(1,047)
Balance, December 31, 2006	**7,130**

Dividend Payable

On November 8, 2006, the Board of Directors declared a semi-annual dividend of seven and one-half cents ($0.075) per common share payable on January 2, 2007 to shareholders of record on December 15, 2006. The Company has accrued $5,903 for this dividend in the 2006 consolidated financial statements and has transferred the amount of funds required to the transfer agent in December 2006 to be held in trust until the dividend payment is made.

10. Provision for Income Taxes

The provision for income taxes, including future income taxes, reflects an effective income tax rate that differs from the actual combined Canadian federal and provincial statutory rates of 32.50% (2005 – 33.62%). In addition, Pason Systems USA Corp. is subject to federal and state statutory tax rates of approximately 40% for both 2006 and 2005. The main differences are as follows:

	2006	2005
	($)	*($)*
Earnings before income taxes	**98,096**	76,337
Expected income tax at statutory rate	**31,881**	25,664
Increase (decrease) resulting from:		
Tax rates in other jurisdictions	**417**	316
Stock-based compensation	**1,494**	873
Non-taxable dividends	**(402)**	(422)
Other permanent differences and other items	**175**	(374)
Provision for income tax expense	**33,565**	26,057

10. Provision for Income Taxes (continued)

The provision for future income taxes arises from temporary timing differences in the recognition of revenue and expenses for income tax and accounting purposes. The net future income tax liability as at December 31 is comprised of the following temporary differences relating to:

	2006	2005
	($)	*($)*
Working capital items	**(1,832)**	(440)
Capital assets	**6,132**	9,192
U.S. non-capital tax losses	**–**	(2,734)
	4,300	6,018

During the year, the Company utilized U.S. non-capital tax losses of $7.7 million that were carried forward from 2005 to reduce current income taxes otherwise payable.

11. Financial Instruments and Credit, Currency and Interest Risks

Fair Values

The carrying values of financial instruments, which include cash, accounts receivable, investments, accounts payable and accrued liabilities, income taxes payable and dividends payable approximate fair value due to the short-term nature of these instruments. The carrying value of the Company's credit facilities also approximates fair value as they bear interest at floating market rates.

Credit Risk

The Company is exposed to credit risk to the extent that its customers, operating primarily in the oil and natural gas industry, may experience financial difficulty and would be unable to meet their obligations. However, the Company has a large number of customers, which minimizes concentration of credit risk, and in addition, assesses the credit worthiness of its customers on a continual basis.

Foreign Exchange Risk

A significant portion of the Company's operations relate to its subsidiary located in the United States that is considered self-sustaining. As a result of fluctuations in the Canadian dollar relative to the U.S. dollar, the Company may be exposed to foreign exchange risks.

Interest Rate Risk

The Company is exposed to interest rate risk on its market rate credit facilities.

12. Per Share Amounts

Basic earnings per share figures have been calculated using 77,899 (2005 – 76,240) weighted average number of common shares outstanding during the year. Diluted amounts per share have been calculated based on the treasury method using the weighted average number of common shares and dilutive equity instruments representing an additional 2,188 shares (2005 – 2,304) for a total of 80,087 shares (2005 – 78,544) used to calculate diluted earnings per share figures.

Excluded from the calculation of diluted earnings per share were weighted average options outstanding of 789 shares (2005 – 1,541) as the options' exercise price was greater than the average market price of the common shares for the year.

13. Segmented Information

The Company operates in three geographic segments within one industry segment. Rental services are provided in Canada, the United States and internationally (South America, Mexico and Australia). The amounts related to each segment are as follows:

	Canada	United States	International	Total
	($)	($)	($)	($)
2006				
Revenue from external customers	**119,662**	**115,227**	**5,695**	**240,584**
Depreciation and amortization	**20,737**	**18,170**	**1,016**	**39,923**
Operating costs	**48,128**	**47,253**	**1,384**	**96,765**
Segment operating profit	**50,797**	**49,804**	**3,295**	**103,896**
Interest				**622**
Corporate expenses				**581**
Stock-based compensation				**4,597**
Income taxes				**33,565**
Earnings				**64,531**
Capital assets	**100,038**	**64,936**	**6,484**	**171,458**
Capital expenditures	**23,906**	**40,862**	**6,465**	**71,233**
2005				
Revenue from external customers	104,850	66,722	4,175	175,747
Depreciation and amortization	17,619	9,077	502	27,198
Operating costs	34,964	32,587	1,101	68,652
Segment operating profit	52,267	25,058	2,572	79,897
Interest				547
Corporate expenses				418
Stock-based compensation				2,595
Income taxes				26,057
Earnings				50,280
Capital assets	96,754	43,269	4,376	144,399
Capital expenditures	46,031	26,316	3,717	76,064

14. Commitments

Minimum future lease payments required primarily for operating leases for certain facilities and vehicles payable over the next five years are as follows:

	Amount
	($)
2007	5,342
2008	3,710
2009	2,983
2010	1,972
2011 and thereafter	3,443

15. Non-Cash Working Capital

Changes in non-cash working capital are comprised of the following:

Years Ended December 31,	2006	2005
	($)	($)
Increase in accounts receivable	**(5,231)**	(28,380)
Increase in prepaid expenses	**(231)**	(1,073)
Increase in accounts payable and accrued liabilities	**4,100**	1,731
(Decrease) increase in income taxes payable	**(1,734)**	5,717
Foreign exchange	**(1,160)**	(963)
	(4,256)	(22,968)

16. Contingencies

The Company has defended its position in patent infringement lawsuits in Canada and the United States regarding the Company's AutoDriller. In 2004 in the United States, the trial court refused to grant the requested injunction to prevent the Company from renting the AutoDriller in that country. In 2006, a Federal Appeals Court vacated the trial court ruling and remanded the case to the trial court to hold a full trial on the merits of the claim of infringement and the Company defences, including that the patent in question is invalid and that there is no infringement.

In the Canadian case, the matter is in the early stages. At this time, management's assessment of the outcomes continues to be that the asserted patents are not valid, and the Company does not infringe on any valid claims, and as a result, they are not expected to have a significant adverse impact on the Company's financial position or operations. Accordingly, no amount has been accrued for any potential loss under these claims in the consolidated financial statements at December 31, 2006.

The Company is involved in other legal actions and potential claims in the normal course of business. In the opinion of management, the aggregate amount of any potential liability is not expected to have a material adverse impact on the Company's financial position or results.

Historical Review

Selected Financial Data

Years Ended Dec.31,	**2006**	2005	2004	2003	2002	2001	2000	1999	1998	1997
(000s, except per share data)	*($)*	*($)*	*($)*	*($)*	*($)*	*($)*	*($)*	*($)*	*($)*	*($)*
Operating Results										
Revenue	**240,584**	175,747	122,212	91,801	55,311	63,016	42,144	24,668	23,768	14,496
Expenses										
Rental services	**63,966**	45,661	33,468	23,367	17,159	13,641	9,290	5,649	4,830	2,348
Geological services	**8,967**	6,532	4,954	4,283	4,608	6,262	5,326	3,852	3,568	911
Manufacturing & distribution	**9,459**	6,422	3,579	2,835	2,359	2,551	1,900	1,426	1,125	740
Administration	**6,699**	4,076	3,062	2,647	2,427	2,415	2,826	1,867	1,631	702
Research & development	**8,255**	6,379	4,995	3,663	3,009	2,750	2,006	1,403	967	508
Stock-based compensation	**4,597**	2,595	1,290	170	–	–	–	–	–	–
Depreciation & amortization	**39,923**	27,198	18,992	15,017	8,913	7,341	5,340	2,898	2,584	1,689
Earnings	**64,531**	50,280	33,842	24,596	9,606	15,437	8,117	4,084	4,900	4,102
Per share – basic	**0.83**	0.66	0.46	0.34	0.14	0.23	0.12	0.06	0.08	0.07
Cash flow from operations	**107,451**	79,369	54,640	40,463	18,534	24,941	14,797	7,966	7,417	6,014
Per share – basic	**1.38**	1.04	0.73	0.56	0.26	0.36	0.22	0.12	0.12	0.11
Capital expenditures	**71,233**	76,064	41,518	34,041	14,069	22,921	23,419	10,851	8,294	7,957
Financial Position										
Current assets	**93,846**	66,527	39,024	31,064	22,728	20,276	18,150	11,461	10,470	10,529
Total assets	**270,860**	216,306	139,012	112,289	90,191	82,252	64,451	40,193	30,736	25,179
Working capital	**58,495**	23,684	21,540	9,235	4,295	5,135	1,416	3,283	5,769	3,824
Long-term facility	**–**	4,286	–	–	115	395	635	–	–	233
Future income tax	**4,300**	6,018	6,781	6,558	6,268	6,284	3,800	2,159	1,030	860
Shareholders' equity	**231,209**	163,159	114,747	83,902	65,878	53,941	35,448	26,261	22,639	16,878
Return on shareholders' equity	**33%**	36%	34%	33%	16%	35%	26%	17%	24%	41%
Common Share Data (1)										
Common shares outstanding *(#)*										
At December 31	**78,738**	77,045	75,530	73,784	71,612	69,744	67,156	65,184	64,676	63,600
Weighted average	**77,899**	76,240	74,658	72,700	70,992	68,588	66,416	65,028	64,412	56,232
Share trading										
High *($)*	**19.20**	15.13	9.90	6.38	3.34	2.59	2.44	1.73	2.13	1.63
Low *($)*	**13.11**	8.86	5.75	2.91	2.16	1.50	1.38	0.56	0.63	1.58
Close *($)*	**13.26**	14.45	9.25	6.30	2.99	2.28	1.74	1.56	0.73	1.63
Volume *(#)*	**22,804**	22,884	36,900	18,540	21,916	17,692	12,932	13,064	19,948	17,688

(1) *Share statistics have been adjusted historically to reflect a two-for-one stock split in 2006 by doubling volumes and reducing prices in half.*

Pason Systems Inc.

2006 Annual Report

Pason is the world's largest provider of rental oilfield instrumentation systems that are designed and manufactured for use on land-based drilling and service rigs. Pason offers a tightly integrated package of complex services including data acquisition, wellsite reporting software, remote communications and Internet information management tools.

Pason's strategic focus on unique proprietary solutions and providing the industry best in customer care gives it a competitive advantage in bridging the physical separation between the remote wellsite and the office. Leveraging these services on its dominant Canadian wellsite presence, a leading position in the United States, and growing operations in South America and Australia, has created strong year-over-year revenue gains from each product line and an annual average 30% return on shareholders' equity over the past decade.

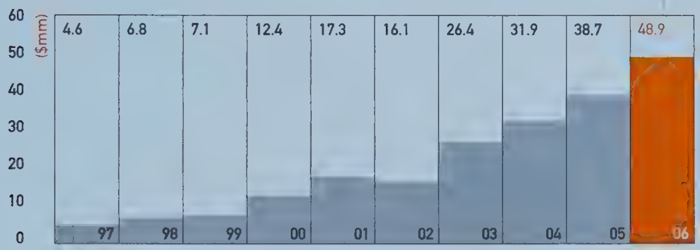
Pason is a Canadian corporation with its head office located in Calgary, and United States offices in Golden and Houston. Common shares of Pason Systems Inc. are listed for trading on the Toronto Stock Exchange under the ticker symbol PSI.

my pason

Our Company thrives on identifying challenges at the wellsite and then developing unique proprietary instrumentation and data solutions to solve those problems. At Pason, we have created an energized, focused and relaxed work environment that empowers each employee to push the envelope of traditional thinking in order to create new solutions to old problems.

One example of this forward thinking is the development in 2003 of our Automatic Aiming Satellite System. The System provides a high-speed Internet connection to drilling rigs and is equipped with proprietary hardware and software that finds the satellite automatically as a rig moves from one wellsite to the next. In the back pocket of this package, you will find a model of our satellite dish. We invite you to take a moment to experience our Company by assembling the model and making this Your Pason.

my participation



PVT REVENUE

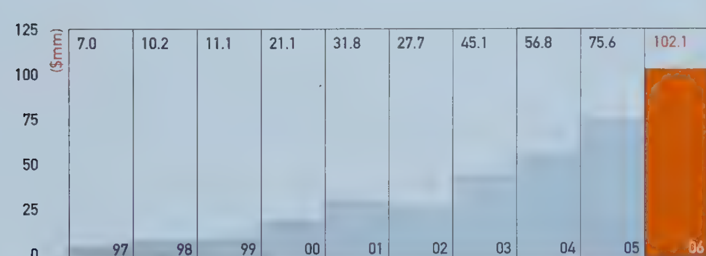
NODEN - FIELD TECHNICIAN

I'm a Pason field technician responsible for the installation and service of our many instrumentation systems, including the Pit Volume Totalizer (PVT) that detects "kicks" that are caused by hydrocarbons entering the wellbore. Often I will have an idea on how to improve a product's performance. Our Company's hardware engineers and software developers back in the office always listen to my suggestions and build from my on-site experience. It's great to work in an environment that values each person's ideas.

my purpose

- SOFTWARE TESTING ANALYST

I'm a software developer and have worked on several of Pason's core products such as our Electronic Drilling Recorder (EDR), which is a complete system of instrumentation and monitoring equipment. My programming expertise along with practical ideas that come directly from the field help me to expand the product's capabilities. It is satisfying to see my efforts being implemented in the field and helping to meet our customers' changing needs.



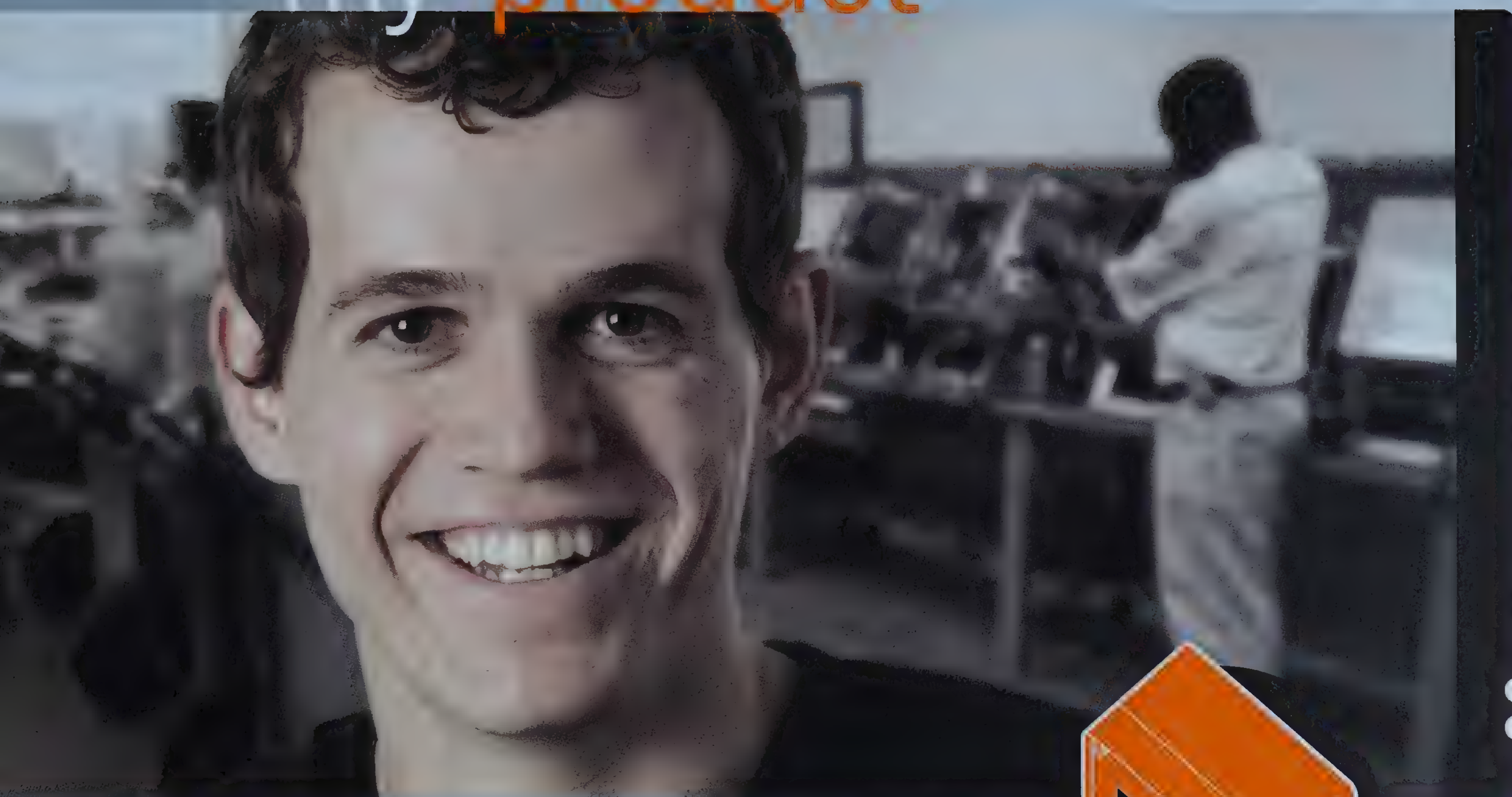
EDR REVENUE

AUTODRILLER
REVENUE

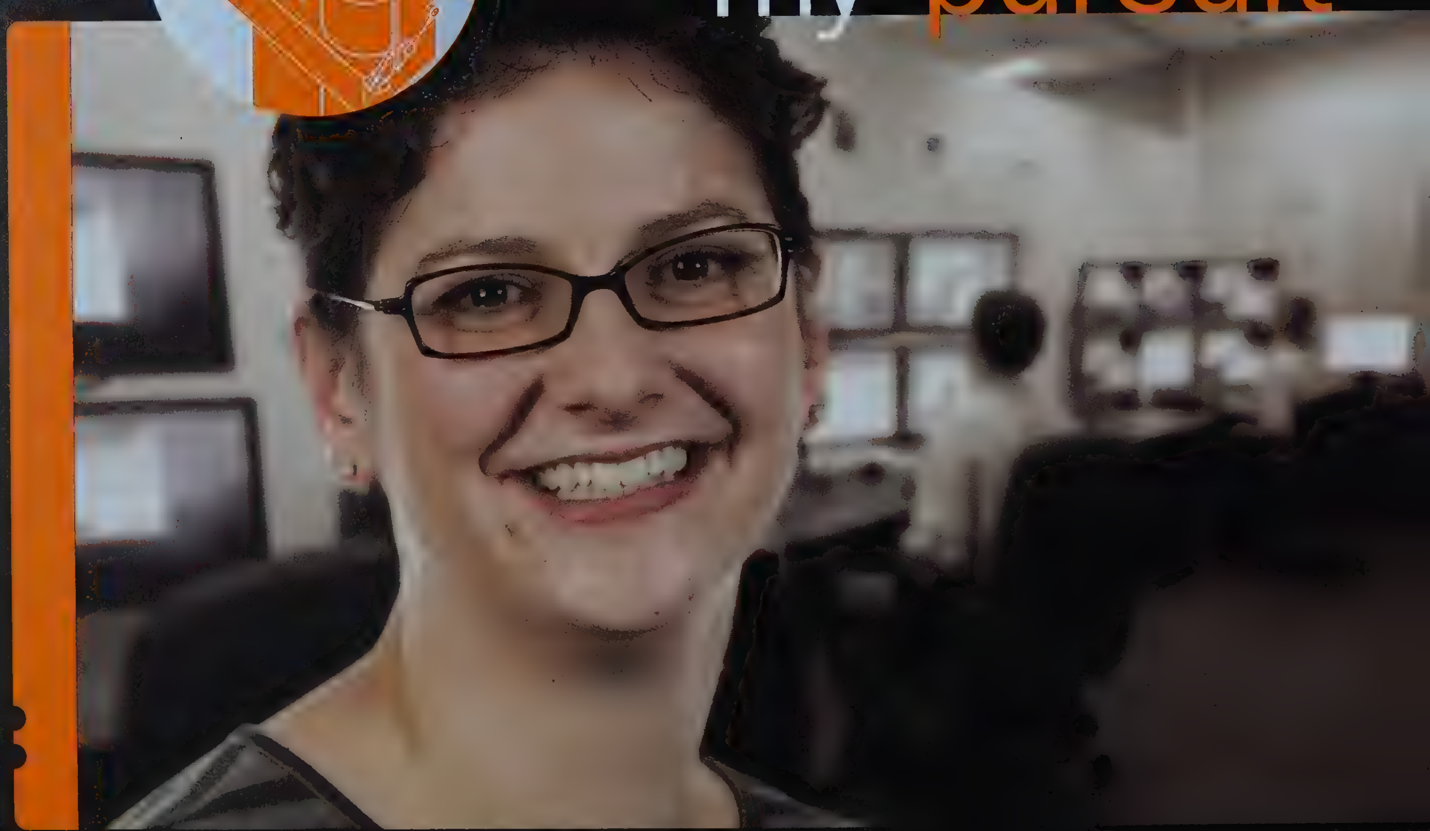
DANIEL – HARDWARE DESIGNER

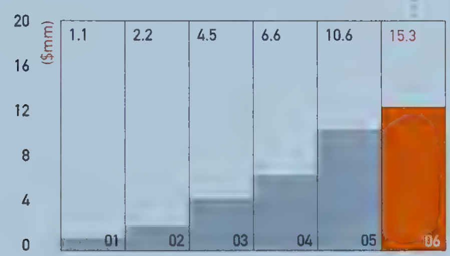
I'm a design engineer developing specialized products such as our AutoDriller that is used to maintain constant weight on the drill bit while a well is being drilled. Our products start from an initial concept, then numerous field tests are performed to work out any glitches, and finally I help to see the product through the manufacturing stage to installation. I work with a supportive team and take personal ownership in each product I help develop.

my product



my pursuit





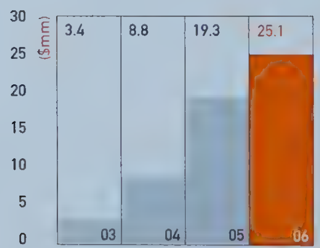
TGAS REVENUE

JESSICA - SUBSURFACE MAPPING GEOLOGIST

My first job out of college was as a field geologist with Pason. Now I work in the geology command centre in Golden, Colorado providing on-site monitoring and analysis. This is an exciting starter job where every day I am gaining new and valuable career building experience as I work with the industry's top analyzing equipment such as Pason's Total Gas System (TGAS), a proprietary system that measures the total hydrocarbon gases exiting the wellbore. The knowledge that I am gaining is preparing me for new opportunities within the Pason organization. This is a company where I can truly learn and grow.

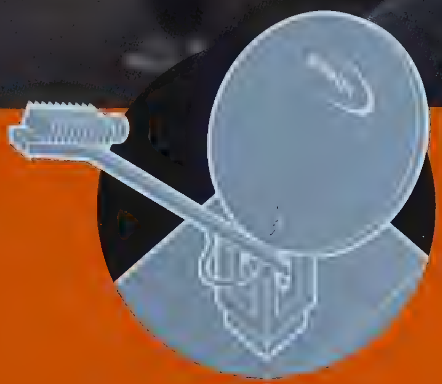
- SENIOR LINUX ADMINISTRATOR

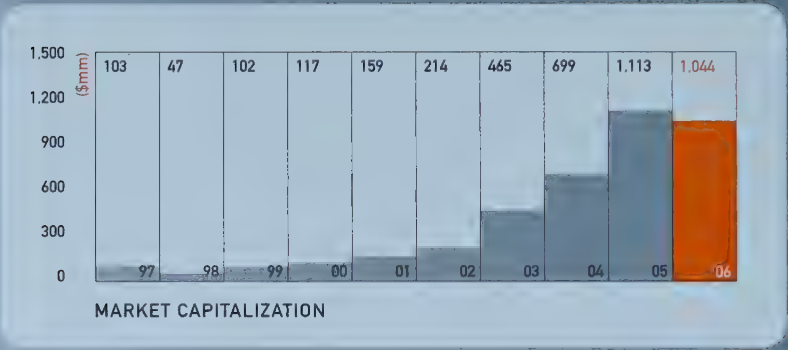
I'm a systems analyst. It's exciting working for a company that is dedicated to developing leading edge technologies, such as Pason's Automatic Aiming Satellite System that works together with our Internet DataHub to transfer real-time wellsite data to our customers' desktops. At Pason, we are constantly looking for new ways to solve old problems as well as to improve our existing products and systems.



COMMUNICATIONS REVENUE

my pason

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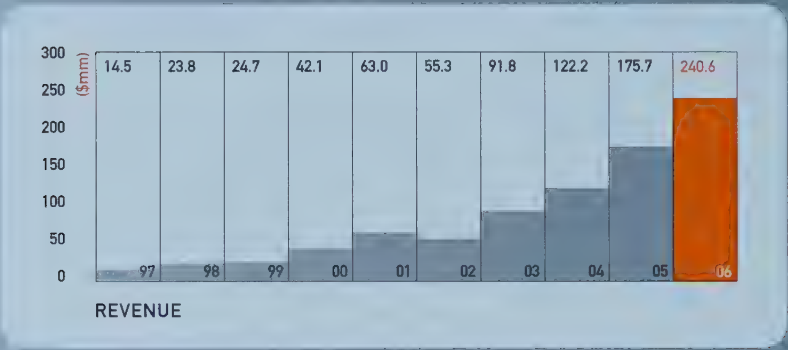
MARKET CAPITALIZATION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REVENUE


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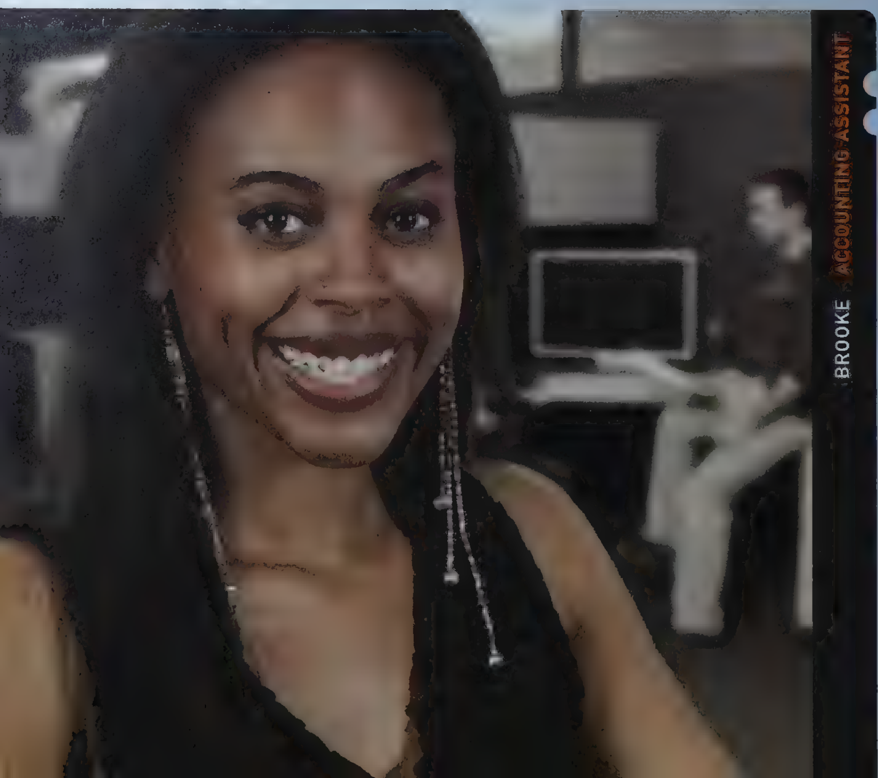
RETURN ON SHAREHOLDERS' EQUITY


BROOKE
ACCOUNTING ASSISTANT

Performance Data

	THREE MONTHS ENDED DECEMBER 31,			YEARS ENDED DECEMBER 31,		
	2006	2005	Change	**2006**	2005	Change
(000s, except per share data) (unaudited)	*($)*	*($)*	*(%)*	*($)*	*($)*	*(%)*
Revenue	**59,960**	56,057	7	**240,584**	175,747	37
Earnings	**15,079**	17,314	(13)	**64,531**	50,280	28
Per share – basic (1)	**0.19**	0.22	(14)	**0.83**	0.66	26
Per share – diluted (1)	**0.19**	0.22	(14)	**0.81**	0.64	27
Cash flow from operations (2)	**24,818**	26,758	(7)	**107,451**	79,369	35
Per share – basic (1)	**0.32**	0.35	(9)	**1.38**	1.04	33
Per share – diluted (1)	**0.31**	0.35	(11)	**1.34**	1.01	33
Common share dividends						
Per share (1)	**0.075**	0.05	50	**0.125**	0.0875	43
Capital expenditures	**24,436**	21,199	15	**71,233**	76,064	(6)
Working capital	**58,495**	23,684	147	**58,495**	23,684	147
Total assets	**270,860**	216,306	25	**270,860**	216,306	25
Shareholders' equity	**231,209**	163,159	42	**231,209**	163,159	42
Return on shareholders' equity *(%)*	**–**	–	–	**33**	36	(8)
Market capitalization	**1,044,000**	1,113,000	(6)	**1,044,000**	1,113,000	(6)
Weighted average shares outstanding *(#)*	**78,654**	76,898	2	**77,899**	76,240	2

(1) Historical per share information has been adjusted for the two-for-one stock split approved by shareholders May 15, 2006.

(2) For the purposes of cash flow per share calculations, cash flow is defined as earnings adjusted for depreciation and amortization, stock-based compensation expense and future income taxes. Return on shareholders' equity is calculated as earnings over the simple average of the beginning and ending shareholders' equity. Both definitions are not recognized measures under Canadian generally accepted accounting principles, and accordingly, may not be comparable to measures used by other companies.

president's message

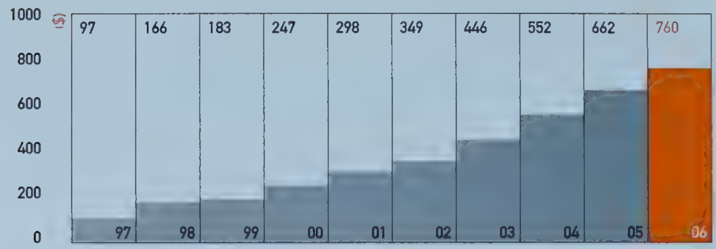
JIM HILL – PRESIDENT & CHIEF EXECUTIVE OFFICER

At Pason, we have built an atmosphere that continues to nurture an imaginative, enthusiastic, dedicated and skilled team that works hard to achieve our corporate goals – as evidenced by another record year of outstanding financial and operating performance.

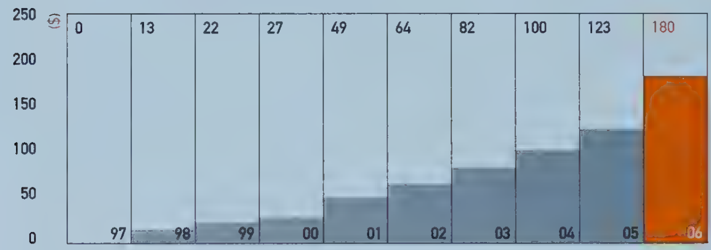
While 2006 was another record year for Pason in all financial metrics, we clearly limped home to that result with last half results weakening substantially in Canada. Revenue was $240.6 million, a 37% increase over 2005, net earnings rose 28% to $64.5 million and earnings per share came in at $0.83 versus $0.66 the prior year. Our return on shareholders' equity still surpassed our internal 30% target at 33% compared to the 36% we achieved in 2005.

In my message last year, I wrote a section titled "What Happens When the Boom Ends?" Unfortunately, my comments turned out to be rather prophetic. Running a profitable business in the oilfield service industry is challenging because apparently the efficient market theory doesn't always exist. To illustrate, imagine a homeowner with a damaged roof and it begins to rain. Desperate to complete the project, the homeowner hires a contractor with a crew of roofers at a costly price. The contractor puts too many men (most of whom are inexperienced) on the project so that the job is getting done, but not very efficiently. Finally the rain stops, and although the roof is not yet complete, the homeowner releases the contractor and his crew that could now work more slowly and effectively. This occurs even though it is inevitable that two things will happen: (1) it will rain again, and (2) the roof still requires work. Substitute oilfield services for the roofing contractor and the challenges are the same. Accordingly, in the balance of this message, I will try to explain how Pason will meet these challenges.

In Canada, the drilling decline was most noticeable in the fourth quarter when drilling days dropped to 35,700 from 48,800 in 2005. This 13,100-day reduction cost Pason about $9.3 million in revenue, and because almost all of our costs are fixed in the short-term, an almost identical reduction in margin resulted. Somewhat offsetting the decline in days, we were able to increase the revenue that we generated per industry drilling day, which was $717 for the fourth quarter and $760 for the full year compared to $709 and $662, respectively, in 2005. This increase in revenue per day was due to adding more products per wellsite, primarily our Total Gas System, AutoDriller and Satellite communications, which were up 35%, 46% and 19%, respectively, from the prior year.



RENTAL REVENUE PER CANADIAN INDUSTRY DRILLING DAY



RENTAL REVENUE PER U.S. INDUSTRY DRILLING DAY

Our new Electronic Service Recorder (ESR) has now been installed on over 200 rigs with a major service rig contractor, thereby demonstrating its potential and providing $1.1 million of revenue in 2006. The use of this product is a new expense item for customers, which is always a hard sell, but we believe we are making headway in proving its value. Subsequent to year-end, a major operator customer decided that an ESR was mandatory on all of its long-term contracted service rigs. We continue to believe that a service rig revenue stream is very important because it offers the opportunity to partially even out the cycles of the drilling industry. Late in the year, we also introduced an H_2S and explosive gas monitoring system that is more robust than other offerings in the market and efficiently integrates into our base rig data acquisition system. Early interest in this new product has been greater than expected and we are now planning to step up its production. We also continue to market and demonstrate our vision of more remote command centre management for drilling to a variety of service companies. We are hopeful that in the current environment of reduced drilling activity and a greater focus on drilling costs, that this different service model will garner greater attention.

In the United States, we had a breakout year with segment operating profit doubling over the prior year to $49.8 million, not far behind the $50.8 million recorded in Canada. This profit jump resulted from our increased penetration onto U.S. rigs, where we are now installed on 50% of all active land-based rigs, and a strong revenue per industry day increase to $180 from $123 recorded in 2005. We are beginning to demonstrate to U.S. customers that we provide the most reliable wellsite data acquisition solutions that are backed by the highest quality field service structure. While the margin or leverage on our field service resources is not yet where we would like it, we clearly have established a reputation as being the premier provider of these specialized services. To date, most of our rig installations involve just an Electronic Drilling Recorder, Pit Volume Totalizer and Satellite communications. Throughout 2007, we hope to continue to increase revenue from new rigs and backfill our existing wellsites with more of our products.

Our geological services division continues to grow and contributed $6.2 million of margin compared to $3.8 million in 2005. Over the past 18 months, we have doubled the number of geologists we can mobilize in the field, while at the same time our command centre in our Golden office continues to demonstrate to customers that valuable geological expertise can be provided to the well without any onsite geology presence. The experience we are gaining with our command centre is invaluable, not only for the geological revenue it provides, but also as a working pilot project to demonstrate to other services in bits, mud and directional, what could be possible in their businesses.

Our international business unit comprises primarily Argentina, and to a lesser extent Ecuador, Columbia, Peru, Mexico and a start-up in Australia. Segment operating profit increased to $3.3 million compared to $2.6 million in 2005. In Argentina, we are encouraged by the interest in our newer products. The AutoDriller has been extremely well received to date and there has also been keen interest in our ESR, arguably even greater than in Canada. Our South American partner, having made beachheads in all South American oil producing countries except Venezuela, is currently refocusing on Argentina where the largest number of rigs and revenue growth opportunities exist. During 2007, we expect a very strong year in that country.

Growing as rapidly as Pason has over the past ten years clearly puts pressure on all the operational and administrative systems needed to power the Company. Typically in years of receding industry activity, we take advantage of reduced external demands to retool our systems and people to meet the inevitable surge in activity and demands that always follow each lull period. Currently, we have a major “simplification” push in our Calgary office involving all of the senior managers. Our goal is not to make minor tweaks, but rather substantial, elegant simplifications to our contract manufacturing, capital asset tracking and billings management systems that will dramatically reduce the human effort and risk of errors. Success in this initiative will result in more personnel and energy to attack the core tasks of Pason that will provide a competitive edge. If we are successful, we would expect to show even better margins when the market turns back to full activity. Finding good people, especially in the field and for R&D, continues to be a challenge. To aid in that task, we recently hired a senior HR manager with the clear mandate to directly assist the managers in recruiting new talent, while at the same time identifying and developing our top internal talent.

Predicting oil and natural gas prices is notoriously difficult due to a host of global economic, political and environmental issues. As a result, it is hard to forecast the market for our predominantly drilling rig related services. However, I can put forth some of the economic ideas I see as being relevant to our industry. No new energy source is on the horizon that promises to replace the need for crude oil and natural gas in the near-term. Ethanol blended gasoline is being touted, but even at a modest contribution to reducing oil for gasoline requirements, the price of corn is rapidly rising and there is a shortage of land to grow the corn, not to mention the oil and gas needed to support the increased farming operation. Nuclear energy is showing renewed interest, but the price of uranium is escalating exponentially, while wind power has raised concerns about being too unreliable for major dependence and fuel cells have failed to deliver their predicted savings.

There is no credible reason to believe either that the world demands for energy will fall or that producing fossil fuels will become cheaper. At the same time, there is also no disputing the fact that the decline curves of the producing wells are getting steeper. FirstEnergy Capital Corp. of Calgary has already predicted that declining drilling activity will reduce natural gas exports to the United States in 2007 by one billion cubic feet per day or 10% of the current total. Using another Calgary information source, Mr. Peter Tertzakian, economist and author of A Thousand Barrels A Second, likens the current market to that of the late stages of the whale oil market in the mid-19th century. As whales became more scarce and ships had to travel further, more ships were built and deployed, reaching a surprising 678 vessels in 1842. I am using this very old example because it is still valid today. Whaling activity increased exponentially at the end until the need for whale oil was replaced by the much cheaper energy source, kerosene. In exactly the same manner, drilling activity will also grow strongly until some suitable, cheaper alternative supplants oil and natural gas. That alternative is not clearly visible today, and even after it becomes clear, it will take at least a decade to build a new delivery infrastructure. I fully believe that there are still many years of aggressive drilling ahead in our industry.

The Pason story remains exciting and full of potential. I would like to thank all employees, customers and suppliers who contributed to another record year.

On behalf of the Board of Directors,

JIM HILL
President & Chief Executive Officer

March 1, 2007

Late in 2006, we introduced an H_2S and explosive gas monitoring system. The system is more robust than any other offering in the market and integrates into our base rig data acquisition system. Early interest in this new product has been greater than expected and we are now planning to step up its production.

Corporate Information

DIRECTORS

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Calgary, Alberta

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President
Bragg Creek Financial Consultants Ltd.
Calgary, Alberta

Catherine Hughes, BSc[(2)(3)]
Vice President Exploration & Production Services
Husky Oil Operations Limited
Calgary, Alberta

Peter S. Mackechnie, CA[(3)]
Private Investor
Vail, Colorado

(1) Audit Committee Member
(2) Compensation Committee Member
(3) Corporate Governance Committee Member
(4) Chairman of the Board

OFFICERS AND KEY PERSONNEL

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Jim Hill
President & Chief Executive Officer

Jim Glasspoole
Chief Financial Officer

Bob Rodda
Canadian Business Unit Manager

Lucy Tomie
Financial Controller

David Elliott
Treasurer

David White
R&D Manager

James Parks
Quality Assurance Manager

Ken Ledger
Risk Manager

Ron Dudar
Human Resources Manager

Joe Seeman
Contract Manufacturing Manager

Pason Systems USA Corp.

Jim Hill
Chairman of the Board

Greg Lindsay
President

Ben Thomas
Sales Manager

Jerry Aberle
Chief Financial Officer

Joe Watson
Geological Services Manager

Lee Maassen
Controller

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REGISTRAR AND TRANSFER AGENT
Valiant Trust Company
Calgary, Alberta

STOCK TRADING
Toronto Stock Exchange
Trading Symbol: PSI

ANNUAL MEETING
The Annual General Meeting of Shareholders of Pason Systems Inc. will be held on Monday, May 14, 2007 at 3:30 p.m. (Calgary time) in the offices of Pason Systems Inc., 6130 Third Street S.E., Calgary, Alberta. Shareholders who are unable to attend the Meeting are requested to complete and return the Instrument of Proxy to Valiant Trust Company at their earliest convenience.

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